

**Statement of the  
Rail Customer Coalition**

**Before the  
Committee on Commerce, Science and Transportation  
Subcommittee on Surface Transportation and Merchant  
Marine  
United States Senate**

**On The  
REAUTHORIZATION OF  
THE SURFACE TRANSPORTATION BOARD**

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## EXECUTIVE SUMMARY

This testimony is on behalf of the Rail Customer Coalition, which is comprised of agricultural, mining, chemical, plastics, forest and paper products, and transportation intermediary interests. This large and diverse coalition is united in support of the need for additional rail competition.

The testimony provides a brief summary of the members of the coalition and why they are concerned about rail transportation. It then reviews the need for changes in the existing law and provides specific recommendations for what those changes ought to be.

Below is a summary of the six provisions that rail customers recommend for inclusion in legislation to reauthorize the STB:

1. Policy. Clarify the rail transportation policy of the US by requiring the Surface Transportation Board to give greater weight to the need for increased competition between and among rail carriers.
2. Bottlenecks. Require rail carriers to quote a rate between any two points on the system where traffic originates, terminates or may reasonably be interchanged without regard to whether the rate is for only part of the total movement.
3. Competition in Terminal Areas. Eliminate the requirement that evidence of anti-competitive conduct be produced when the STB determines outcome of requests to allow another railroad access to rail customer facilities within an area served by the tracks of more than one railroad.
4. Relief for Certain Agricultural Shippers. Provide small, captive agricultural shippers with a simple benchmark test for rate and service cases.
5. Market Dominance. Codify the STB's decision to exclude evidence of product or geographic competition when determining market dominance.
6. Revenue Adequacy. Abolish the requirement that the Board determine on a regular basis which railroads are revenue-adequate.

## INTRODUCTION

Good morning, madam chairman and members of the subcommittee. I am Bill Harvey, Global Logistics Development Manager for Lyondell Petrochemical Company. I am here today representing a large and

diverse group of rail customers. These rail customers come from every region of the country and include agriculture, utilities, mining, transportation intermediaries, chemical and plastics, and forest and paper products. We all have a common concern: the need for high quality, reliable, and reasonably priced rail transportation. And we all believe that encouraging competition between railroads is the way to achieve improved rail transportation.

We commend you for beginning the process of reauthorizing the Surface Transportation Board (STB), the agency charged with regulatory authority over the rail industry. However, the changes that have taken place within the rail industry demand a reexamination of the application of current policy, remembering that it was the stated intent of existing law to **encourage** competition among railroads. There is no better opportunity to refine current policy than when the responsible agency is subject to reauthorization. It is for that reason that the members of the rail customer coalition believe so strongly that STB reauthorization must include several discrete revisions to the law that will balance the interests of rail customers with those of the rail carriers. Currently the STB does not do this.

Our position has been described by some as “re-regulating” the rail industry. I must strongly state that we do not support returning to rail regulation as it existed prior to the enactment of the Staggers Rail Act of 1980. But we do believe that the pro-competitive intent of the Staggers Act has been undermined by years of protectionist decisions rendered by regulators. As customers of the rail industry, we need an efficient, reliable and economically viable railroad system. Without such a system the country’s economy will suffer and we would not be able to receive raw materials and market our products.

At the same time, we need a rail industry that is responsive to the needs of its customers – and that means a rail industry that is not empowered to exploit major portions of its customer base by exercising monopoly market power. This is especially true for the members of the group I am representing today. All of the industries that participate in the group have to compete on a national or global basis. The competition we face daily means not only that we must seek ways to reduce costs, but that we must also get our products to market. There are numerous occasions when shipments must reach a rail destination by a specified time to be loaded on an ocean-going ship or to be used by a customer on a time sensitive basis. If these shipments are late we lose sales or face other negative business consequences, including but not limited to layoffs, downsizing, plant closings, and job losses. And while the immediate impact on the consumer may be hard to see, I can assure you that the

ability of businesses that rely on rail transportation to receive the raw materials they need to produce their products or to get their products to market has a major impact on the daily commerce that you and I have come to take for granted. These are the reasons that rail transportation must be responsive to the demands of the customer. A better balance in the existing regulatory system is clearly needed.

## **WHO WE ARE**

The group that I represent today is composed of a number of different groups. These include agriculture, chemicals, plastics, forest products and paper, mining to utilities to manufacturing. These sectors of the economy are described below along with a brief explanation of why changes in rail transportation are needed.

### Agriculture

Approximately two percent of all Americans are engaged in agriculture as their primary occupation. While it may seem a small number, that two-percent of the population manages to produce enough food and fiber to feed the rest of the country's population, as well as a good part of the rest of the world.

Railroads are an important mode of transportation for the Nation's agricultural shippers. In 1997, railroads moved 1.4 million carloads (126 million tons) of farm products and 1.3 million carloads (86 million tons) of food and kindred products. Although this volume is large, it amounted to only 13 percent of all rail traffic that year.

Railroads are most important in the movement of grain. Grain and oilseed shipments represent about 95 percent of all farm product traffic moving by rail. Since the late 1970's grain tonnages shipped by rail have increased by 23 percent. Railroads also move more grain than barges and as much as all commercial trucks. Railroads account for about 40 percent of all grain shipped from commercial facilities. By comparison, trucks also haul about 40 percent of the grain shipped commercially and barges haul the remaining 20 percent.

Many agricultural shippers are small and face unique challenges in a changing global marketplace. Their exceedingly low profit margins paired with dramatic fluctuations in world economies already place them in a financially precarious environment that Congress has taken a special interest in addressing. These rail customers also have an irrevocable tie

to the railroads because in many cases there is no alternative mode of transportation that makes logistical or economic sense.

Having said that, agricultural shippers in some parts of the United States are paying the highest rail freight rates in exchange for arguably the most sporadic and unreliable service. These shippers need a clearly defined means for securing reliable service at a reasonable rate.

Agricultural shippers are also unique in that the party that bears the cost of rail transportation—the farmer—is not the party that negotiates the rate for that transportation—the grain elevator. Further, the farmer has no ability to pass on the costs associated with transportation to the customer.

Farmers throughout the western states, including Montana, Idaho, North and South Dakota, Washington, Oregon, Colorado and Nebraska, are paying anywhere from 225 to 300 percent or more of the railroads' revenue to variable cost. Any business in the world would be ecstatic to receive that kind of return on its cost. But even if you assume that the high cost of capital for railroads requires railroads to generate 180% revenue to variable cost—a profit margin of 80%—you're still talking about an additional return of 45% or more.

Maybe this doesn't sound unreasonable to you, but I urge you to keep in mind that this kind of profit is being extracted out of a group that is ill-equipped to afford it: the farmer. Consider this example: A bushel of spring wheat currently sells for approximately \$4.15. Roughly \$1.00 of that amount, or one-quarter of the price a farmer receives, goes to pay for rail transportation. Stated another way, the average wheat farmer is working for the railroads nearly three months out of the year. If Congress cares about the future of agriculture, and did not intend to place the railroads in a position where they can exploit every last nickel out of their customers, then changes must be made.

While rates are of great concern to many people in the agriculture industry, receiving reliable service is of equal concern. Crop harvests are naturally cyclical in nature, as opposed to other rail traffic that is more evenly balanced throughout the year. But the movement of grain is largely determined by the demand of the global marketplace. When prices in the marketplace are high, farmers want to move their grain, and vice versa. Yet railroad service—or lack of it—can and has prevented farmers from moving their grain when there is demand. It's important to point out that the agriculture community has long suffered from sporadic and unreliable rail service and so long as current policies are maintained, that situation is expected to continue for the foreseeable future.

Over the last 30 years, the agriculture industry has been subjected to an increasing degree of competition with foreign producers--in both domestic and foreign markets. As in all industries, free markets reward lower-cost producers, and also consistent with other industries, the agriculture industry must search for ways to trim costs in order to remain competitive.

That is why the debate over rail competition has become so important to this industry. For the agriculture industry to remain competitive, it can no longer afford to rely on a rail industry that operates as a virtual monopoly. As a critical underpinning of the national economy, the agriculture community's concerns deserve special consideration.

### Chemicals and Plastics

The U.S. chemical industry (excluding plastic resins) employs some 955,000 high-tech, high-wage workers. In turn, these lead to the creation of 1.1 million jobs in other industries, bringing total U.S. jobs dependant on the chemical industry (excluding plastic resins) to 2.1 million. This industry is the leading export sector and a substantial contributor to a positive US balance of payments. The chemical industry depends heavily on railroads to safely and efficiently transport raw materials to chemical manufacturing facilities and to deliver a wide variety of finished products to destinations throughout the country. Railroads also transport chemical exports to Canada, Mexico, and U.S. ports.

According to data compiled by the Association of American Railroads, the chemical industry ships about 110 million tons of products (excluding plastic resins) by rail on an annual basis and spends more than \$3.5 billion per year on rail freight charges, accounting for 11 percent of the revenue received by U.S. railroads. In many parts of the country, there are chemical manufacturing facilities served by a single railroad, leading to high costs. The chemical industry, which has participated in a number of major STB rail proceedings, strongly supports rail competitiveness and specifically endorses the recommended legislative provisions discussed in my testimony.

The plastics industry directly employs more than 1.3 million workers. When taken into account the upstream industries, that is the supplying industries, the number of plastics industry employees rises to 2.3 million, nearly two percent of the U.S. workforce.

Recent rail transportation events have shaped the business environment of the plastics industry. There is a growing awareness that transportation is not a separate, isolated function of the supply chain, but rather, an integral part of the production process. When talking about the transportation of plastic pellets, you must remember few other issues address such fundamental business components in corporate America. That is, rail transportation is about:

- Moving raw materials and products;
- Meeting customer demand; and
- Affecting the corporate bottom line.

When addressing the importance of rail transportation to the chemical and plastics industries, economics plays a large part. As an example, for plastics:

- Transportation is the second highest cost component in raw material production (second only to feedstock);
- Transportation can account for up to 20% of the finished raw material cost;
- Approximately 60 billion pounds of plastics are shipped each year;
- The plastics industry pays over \$1 billion to the railroads each year;
- If a facility is captive, at the point of origin or destination, rates for the exact same rail movement can be 15-60% higher than from a competitively served facility.

Given the fact that 75% of plastics raw material producers are captive to one railroad, paying higher rates, and generally receiving poorer service - - coupled with the fact that the railroads are the only industry in this country to exercise complete monopoly control over their customers -- the time has come to start asking why the railroads are able to operate in this type of an environment.

The core issue is the lack of competition in the U.S. rail system. Legislation is needed to address the fundamental way railroads operate.

### Forest Products and Paper

The forest, pulp, paper, paperboard, and wood products industry. employs approximately 1.5 million people with a payroll of \$40.8 billion and ranks among the top 10 manufacturing employers in 46 states. It

represents 7.8% of the manufacturing work force in the United States. Sales of forest and paper products exceed \$275 billion annually both here and abroad. For most producers, transportation costs are the third largest operating cost component after fiber and labor. These costs average between 5% to 25% of delivered product costs.

The forest products and paper industry is the fourth largest user of rail transportation in the United States and incurs \$2.9 billion in annual rail expenses which is approximately 9% of all rail revenues. Significantly, the industry's \$183 billion of domestic flows combined with the inland portion of its international flows makes the industry one of the largest commodity shippers in the country. Much of the industry's exports and the domestic sales are transported by rail. In fact, the forest products and paper industry moves an average of 24,000 carloads in any given week using proprietary short line railroads and all Class I railroads. The industry is responsible for 70% of all railroad boxcar traffic, including 19 million tons of recycled paper, and 95% of all centerbeam lumber car traffic. The industry also represents significant carload volumes consisting of inbound raw materials (such as logs, woodchips, coal and chemicals) and thousands of containers carrying finished goods for domestic and offshore distributors. In addition, the industry has a substantial investment in boxcars, tankcars, and other rail equipment.

Rail service problems are currently national in scope. While other transportation modes measure "on time" service in hours, railroads measure it in days. This type of service affects not only the performance of the major remaining railroads, but other connecting railroads and their shippers. For example:

- A forest products company has had a major customer in California insist upon replacing rail service with trucks where the infrastructure to do so does not exist.
- Another company, with four manufacturing operations located in East Texas, experienced service problems with shipments destined to southern California. Rail transit times increased from 14 days to as much as 45 days. Business was consequently lost to competitors as a result of this variable service.
- Delivery problems have caused mill inventories of finished goods to go up. This causes warehousing costs, increased emergency delivery costs, and, ultimately, higher inflation to the general public.
- Variable service, lengthened transit times, and captive pricing contributed to a mill closing by a large forest products company.

The forest products and paper industry needs efficient competitive transportation to be able to compete in a global economy. We are concerned with the changes in the competitive dynamics of the national rail structure and believe that in order to have a healthy transportation industry we need vigorous rail-to-rail competition. Without competition, there is no incentive for the railroads to improve and maintain low cost levels, consistent service levels, and an adequate supply of quality box car equipment. To address the issues of rail service, competition and access, the forest products and paper industry endorses the recommended legislative provisions discussed in my testimony. The forest products and paper industry also encourages rail policy to foster the growth of short line railroads through the elimination of “paper barriers” to enable the free interchange of traffic between and among all connecting railroads.

### Mining and Utilities

Coal shippers, including both electric utility companies and coal producers, have major concerns with the current law governing the railroads. Coal is one of the largest commodities by volume moved by the nation’s railroads. Currently, approximately 54% of the nation’s supply of electricity is generated from coal, the vast majority of that coal moves by rail from the coal mine to the power plant and a significant portion of that coal has, for at least some portion of its movement, only one available railroad transportation option. Thus, a significant portion of the coal moved in the nation is “captive” to a single railroad for transportation. As such, the railroad customer, who is usually the electric utility that buys the coal at the “mine mouth” and is responsible for arranging the movement of the coal to the power plant, does not have the ability to negotiate the terms of its rail transportation in an open and competitive market.

Some characteristics of railroad coal movements are:

- electric generating plants are designed to use a specific type of coal and typically have relatively few options regarding the source of coal that can be used in the plant, which may have a design life of as much as 50 years or more; the source of coal is further restricted by the location of the plant and its access to rail transportation;
- most of the nation’s electric generating plants were built before the railroad mergers of the last two decades severely restricted railroad transportation options;

- normally, the railroad customer (the utility) pays for the railroad cars that move the coal; either the utility or the coal producer pays for the railroad loading facility at the coal mine; and the railroad customer may be forced to pay other costs that traditionally have been considered to be costs to be borne by the railroad;
- coal is moved normally in “unit trains” of approximately 100 cars;
- the unit train movement of coal is highly efficient and extremely profitable for the railroads, particularly where the movement is “captive” and the railroad can demand a price above 180% revenue to variable cost ratio; and
- the railroad transportation cost of coal not only affects the cost of the production of electricity, but the price of coal at the mine mouth, which can, in turn, adversely affect the amount of severance tax that most coal producing states collect from the coal produced in their states.

The first choice of coal shippers is for their transportation arrangements to be negotiated in a competitive marketplace, as are their contracts for the purchase of coal and, increasingly, their contracts for the sale of electricity. Some electric generating facilities have transportation options and are not “captive” to a single railroad. Others have been able to achieve competitive railroad transportation options by financing the construction of connecting track (“building out”) to a competing railroad. The STB and its predecessor, the Interstate Commerce Commission (ICC), have allowed such “build outs” which have been very important, although costly, tools for achieving competitive transportation alternatives.

### Transportation Intermediaries

The Transportation Intermediaries Association (TIA) is the leading organization for North American transportation intermediaries with over 700 member companies. TIA is the only organization representing transportation intermediaries of all disciplines. The members of TIA include: property brokers, domestic freight forwarders, NVOCC's, intermodal marketing companies, perishable commodity brokers, logistics management firms, and motor carriers.

The 46 member companies of TIA who operate intermodal marketing companies (IMC's) urge Congress to support legislation that will promote increased competition and access for rail service for both large and small

rail customers. Increased competition will result in improved customer service from the railroads—particularly for the small to medium size rail customers with whom our members do business. If Congress does not enact rail competition legislation, many small businesses will continue to suffer from poor service and find it increasingly difficult to remain in business due to the lack of safe, efficient transportation on our nation's railroads.

IMC's have also found it exceedingly difficult to even receive rail service for small to medium size customers. Without competition, railroads tend to service larger customers at the expense of the smaller one. TIA believes that this situation must be rectified by Congress and that all rail customers should be given an opportunity to operate in a competitive, free-market environment.

## **BACKGROUND FOR CHANGE**

Four developments over the last twenty years have reduced the competitive transportation alternatives for many “captive” shippers.

### Railroad Mergers and Consolidations

First, the railroad industry has consolidated from approximately 40 major railroads in 1980 to six major railroads today (after the Conrail division is complete). Shortly, there will be two railroads in the west: the Burlington Northern Santa Fe and the Union Pacific; two in the east: the Norfolk Southern and the CSX; and two operating in the middle of the nation and in parts of the northeast: the Kansas City Southern and the combined Illinois Central/Canadian National. In their decisions approving railroad mergers, the ICC and the STB have attempted to maintain for all shippers at least as many transportation options as they had prior to the merger, sometimes using trackage rights and other such agreements to achieve these results, but these efforts have not always been successful.

### “Tie In” Agreements with Shortline and Regional Carriers

Second, there has been a proliferation of short line and regional railroads since 1980 as the major railroads sold off parts of their systems. However, as the major railroads sold portions of their tracks to new short line and regional railroads, the sales agreements often included

provisions requiring the short line to move its freight back to the major railroad, even where movement to a second railroad might be possible. These provisions were approved by the ICC and the STB and have been further protected by the recent agreement between the major railroads and the short line and regional railroads, which itself has been approved by the STB. Thus, competition that could have been created by the creation of these short line and regional carriers has been stifled.

### Lack of Competition in Terminal Areas

Third, in the mid-1980's the ICC adopted an interpretation of the Interstate Commerce Act that allows the railroads to prevent competition from occurring in terminal areas. Terminal areas are those places where the facilities of at least two rail carriers cross and therefore competitive alternatives could be available to rail customers if they were able to be served by more than one railroad. Under its interpretation in the 1986 Midtec case, the ICC determined that railroads could avoid competition in a terminal area unless a shipper or other railroad proves "anti-competitive abuse" by the railroad. No applicant seeking competition in a terminal area has ever been able to prove "anti-competitive abuse". This "anti-competitive abuse" test is not contained in the Interstate Commerce Act as amended by the Staggers Act.

### The Bottleneck Decision

Finally, and perhaps of most concern to railroad customers, is the recent "bottleneck" decision, which is fundamental to the entire issue of competition in the rail industry. On February 10, 1999, the United States Court of Appeals for the Eighth Circuit, in MidAmerican Energy Co. v. Surface Transportation Board, upheld the December, 1996 decision of the STB that allows railroads to "exploit" their bottlenecks. The question of "bottlenecks" is now a public policy issue ripe for resolution by Congress.

That judicial decision in the bottleneck case is that under current law railroads can avoid competition and "exploit" their customers located on railroad bottlenecks. Under this decision, the railroads have been given the best of both worlds: the benefits of deregulation and the ability to "exploit" their monopoly facilities! This state of the law must be reversed by an act of Congress.

By way of background, "bottlenecks" are those sections of a transportation movement where only one railroad is available. Typically, for much of the remainder of the movement, competitive rail transportation options are available. "Bottlenecks" are a problem where

one of the two railroads that could provide competition also controls the “bottleneck”. Where the “bottleneck” carrier can provide service at the “origination” of the movement and at the “destination” of the movement, then the “bottleneck” carrier has every economic incentive to exclude the other railroad from participation in a part of the overall movement. Thus, the “bottleneck” railroad either will not provide a rate across only the “bottleneck” portion (thus preventing the customer access to the railroad competition that is available) or will quote a rate for its portion of the movement that is so high as to make the joint-line portion economically infeasible.

In December, 1996, the STB sided with the railroads in its “bottleneck” decision, succumbing to their unsubstantiated claims that they would fall into financial ruin if they could not “exploit” their customers across their bottleneck facilities. Captive rail shippers are outraged by this decision. If this decision stands, the railroad industry will be the only “network” industry that has been both deregulated, but allowed to continue to “exploit” its “essential facilities”. This privilege was not extended to the airline industry, the telecommunications industry, the natural gas pipeline industry or the electric utility industry. In each of these cases, either Congress or the Federal regulatory agency has required these industries to allow competitive rates across their “bottleneck” facilities. Railroad customers demand to know why a different decision was made in the case of the railroads, why their interests have been dismissed and what standard is going to restrain the railroads “exploitation” of those over whom the railroads continue to enjoy monopoly power.

Railroad customers encourage Congress to adopt legislation overturning the “bottleneck” decision and requiring the railroad at least to quote a rate to customers across bottleneck facilities. Railroad customers are not even asking the Congress to dictate the rate, as has been in the case with respect to the telecommunications, pipeline and utility industries. If Congress lets this “bottleneck” decision stand, transportation competition simply will not exist for most captive rail shippers of bulk commodities.

In light of these four developments, most shippers of bulk commodities do not have access to transportation competition. The choice of these railroad customers is either to keep quiet and accept the transportation terms dictated to them by the railroads or to test the reasonableness of their rate at the STB. Unfortunately, the “rate reasonableness process” at the STB is so difficult, costly, time consuming and cumbersome that few railroad customers ever pursue this remedy. This remedy, by the way, is the only rate relief remedy available to captive rail shippers.

On other matters, STB Chairman Linda Morgan indicated in a letter to Senator John McCain and Senator Kay Bailey Hutchinson, that the agency needs direction from Congress. That letter, dated December 21, 1998, identified a number of areas in which Congress should provide more direction. These requests for direction include: rail competition, revenue adequacy, and so-called “small” rate cases.

### Railroads Unilaterally Raising Volume Caps, Forcing Small Business Out of Intermodal Business

Starting in 1997, some railroads began to unilaterally raise volume caps for Intermodal Carriers (IMC's). For example, the Burlington Northern Santa Fe Railroad gave IMC's three months to meet a 500% increase in the volume of intermodal business done with the railroad per year. The BNSF was ordering this change at the same time that service was at its lowest level since 1995 due to the UP/SP gridlock in the West.

Medium and smaller sized IMC's could not meet these drastic volume increases and had to literally give up their contracts with BNSF. This was an example of exercising market dominant power to the detriment of smaller companies. This move flies in the face of the Staggers Act, legislation meant to promote competition and improved service for both large and smaller rail customers. Unfortunately, the STB has chosen to ignore many of the policy mandates listed in Staggers. For example, the following are listed as rail policy in Staggers:

1. Rail policy should foster sound economic conditions and to ensure effective competition and coordination between rail carriers and other modes;
2. Rail policy should reduce regulatory barriers to entry into and exit from the industry; and
3. Rail policy should prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination.

These policies need to be clarified legislatively and not with any new regulation of the industry. The Staggers Act provides the STB with policy to ensure a competitive, free-market environment for both large and smaller rail customers. It is time the policy is put into practice.

## **RECOMMENDATIONS**

In light of the above, rail customers recommend that legislation to reauthorize the STB include the six provisions summarized here:

1. Policy. Clarify the rail transportation policy of the US by requiring the Surface Transportation Board to give greater weight to the need for increased competition between and among rail carriers.
2. Bottlenecks. Require rail carriers to quote a rate, upon request, between any two points on the system where traffic originates, terminates or may reasonably be interchanged without regard to whether the rate is for only part of the total movement.
3. Competition in Terminal Areas. Eliminate the requirement that evidence of anti-competitive conduct be produced when the STB determines outcome of requests to allow another railroad access to rail customer facilities within an area served by the tracks of more than one railroad.
4. Relief for Certain Agricultural Shippers. Provide small, captive agricultural shippers with a simple benchmark test for rate and service cases.
5. Market Dominance. Codify the STB's decision to exclude evidence of product or geographic competition when determining market dominance.
6. Revenue Adequacy. Abolish the requirement that the Board determine on a regular basis which railroads are revenue-adequate.

Each of these provisions is discussed in more detail below.

#### 1. Policy

Congress should clarify the U.S. rail transportation policy by requiring the STB to give greater weight to the need for increased competition between and among rail carriers.

The current rail transportation policy appears to clearly favor competition as the primary regulator of choice. Currently, the statute appropriately states that, among other factors, it is federal policy:

- to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail;
- to minimize the need for Federal regulatory control and to require fair and expeditious regulatory decisions when regulation is required;
- to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues as determined by the Board;
- to ensure development of sound rail transportation system with effective competition among rail carriers and with other modes, to

- meet the needs of the public and the national defense;
- to foster sound economic conditions and to ensure effective competition and coordination between rail carriers and other modes;
- to maintain reasonable rates where there is an absence of effective competition;
- to reduce regulatory barriers to entry into and exit from the industry;
- to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination; and,
- to provide for the expeditious handling and resolution of all proceedings required or permitted to be brought under this part.

However, a review of the past 20 years of regulatory precedent demonstrates that rail regulators have given disproportionate emphasis to the provision that states that the STB is to allow rail carriers to earn adequate revenues. If Congress truly intended for competition to be the regulator of choice—among rail carriers as well as with other modes—the priorities of this policy need to be clarified legislatively.

## 9. Bottlenecks

Congress should require rail carriers, upon request, to quote a rate between any two points on the system where traffic originates, terminates or may reasonably be interchanged without regard to whether the rate is for only part of the total movement.

In the agency's 1996 "bottleneck" decision, the STB ruled that, in most situations, a rail carrier with a "bottleneck" monopoly can lawfully foreclose alternate and competitive rail routings by another carrier, where the "bottleneck" carrier can provide origin to destination service. Consider the example of a shipper that needs to move his goods 1,000 miles and is served by both Carrier A and Carrier B at his destination, but only Carrier A at his origin. Carrier B interchanges with Carrier A and can provide alternative and competitive rail service over 900 miles of the total movement from the interchange to the destination:

See attached diagram

In the above example, even though Carrier B can provide competition over a large portion of the movement, the STB ruled that Carrier A can simply refuse to interchange with Carrier B for transportation from the interchange to the destination. The STB also ruled that it would not even consider a shipper's challenge to the lawfulness of a rate for this "bottleneck" segment. This means that there can be no review of the reasonableness of a rate for the 100 miles controlled by Carrier A in the above example.

The STB's bottleneck decision should be reversed legislatively, to restore to shippers the right to route over competitive routings at rates produced by the competitive market thorough existing interchanges, and to clarify that the STB can establish a maximum reasonable rate over a bottleneck segment. These changes would ensure that the monopoly bottleneck carrier couldn't take advantage of its pricing power to foreclose competition over the competitive portion of the route. They would permit competition to flourish where it can. These changes would not bring a return to the old "open routing" system, whereby carriers were required to keep even inefficient interchanges open and were required to charge the same rate over all possible routes. Rather, only interchanges already utilized by the carriers would qualify, and rates over various routes would vary as costs and competition demand. Where a carrier controls a bottleneck, its pricing initiative would only be subject to current statutory restrictions against charging unreasonably high rates where there is no effective competition.

Consistent with other congressional deregulatory precedent, railroad customers encourage Congress to adopt legislation overturning the "bottleneck" decision and requiring the railroad at least to quote a rate to customers across bottleneck facilities. Railroad customers are not asking Congress to dictate the rate, as has been in the case with respect to the telecommunication, pipeline and utility industries. If Congress lets this "bottleneck" decision stand, transportation competition simply will not exist for most captive rail shippers.

#### 10. Competition in Terminal Areas

Congress should eliminate the requirement that evidence of anti-competitive conduct be produced when the STB determines outcome of requests to allow another railroad access to rail customer facilities within an area served by the tracks of more than one railroad.

The 1980 Staggers Rail Act specifically allowed competition to occur within terminal areas by means of either "terminal trackage rights" or "reciprocal switching," but regulatory interpretation of the law has prevented this from occurring.

According to 49 USC § 11102. "Use of Terminal Facilities," the law clearly states that the Board may require terminal facilities—including mainline tracks for a reasonable distance outside a terminal—to be used by another rail carrier if it is "practicable" and "in the public interest" so long as it does not "substantially" impair the owner of those facilities to handle its own business. This is referred to as "trackage rights."

This section of the law also clearly states that the Board may require rail carriers in a terminal facility to transfer, or “switch,” a customer’s shipment to another rail carrier—under what is known as “reciprocal switching agreements,”—where such agreements are found to be “practicable and in the public interest,” or “where such agreements are necessary to provide competitive rail service.”

Railroads already can access each other’s customers through either trackage rights or reciprocal switching agreements, and often do. However, the railroads decide unilaterally which customers within the reasonable distance of the terminal area can access such competition, and the competing railroads usually will only agree to an “even swap” of access to specific customers. As a result, most customers that fall within a “reasonable distance” or rail terminal facilities can not get competition through these provisions unless the regulator deems such action to be “practicable and in the public interest” or “necessary to provide competitive rail service”—a function that was originally envisioned and anticipated within the 1980 Act as a means to encourage competition.

Unfortunately, regulators have interpreted the language of the statute to mean that a rail customer must prove that the railroad was undertaking anti-competitive abuse. Rather than affirming the pro-competitive intent of the law, the regulator has determined that trackage rights and reciprocal switching agreements will only be used when anti-competitive behavior can be proven to exist. Although this provision of the law was clearly intended as a means of encouraging an emergence of competition, instead the STB chose to protect the rail industry from competition. Therefore, rail customers are asking Congress to remove the “anti-competitive abuse test” that was superimposed on the current statute by regulators.

#### 11. Relief for Certain Agricultural Shippers

Provide low volume, captive agricultural shippers with a simple benchmark test for rate and service cases.

In the case of the low-volume agricultural shipper, a better test must be established to provide these customers with a quick and simple way to access relief from poor service and unreasonably high rates within the existing regulatory framework. The existing “small rate cases” provision does not work because it does not provide any clear indication of who would qualify, or establish a definitive simple rate or service benchmark.

Consider: STB’s guidelines established three factors that the Board will look at to determine the maximum rate for small shippers. Specifically, the Board reviews the profits that the carrier obtains from the challenged

rate compared to: 1) The profits that railroads in general earn from comparable traffic; 2) The level of profits that the carrier would need to obtain from all of its potentially captive traffic in order to become “revenue adequate”; and 3) The profits that the defendant carrier earns on all of its potentially captive traffic. But the Board has never said how these comparison factors will be weighted or if they will even be utilized, so from a legal standpoint, a small shipper has no means of assessing the potential outcome of bringing a rate complaint.

In addition, there has never been a decision by the Board about what case would qualify as a “small case” so a shipper with a complaint doesn’t even know who can qualify to use these rules. One of the three comparison factors depends upon access to the confidential waybill sample data, and you can’t get access to the data until you file a complaint. Beyond the complexities of the STB’s guidelines, the process is lengthy and costly. The prospect of spending thousands of dollars—or even millions, and weeks—or even years—of time on a process that is unlikely to provide any real relief is not especially enticing, particularly in a fast paced marketplace where other business opportunities could be lost.

In STB Chairman Morgan’s letter of December 21, 1998, she specifically noted that, if Congress agrees with the assessment that the current guidelines could unreasonably impede access to the regulatory process and should be replaced by a single benchmark test, Congress could adopt specific “small” rate case standards.

Various members of the agricultural community have proposed a threshold under which it would be clear what rate and service circumstances would merit regulatory relief. This proposal would also establish the parameters for such relief, and in circumstances where all else fails, allow eligible facilities to sue for damages either in federal court or before the STB.

## 12. Market Dominance

Codify the STB’s decision to exclude evidence of product or geographic competition when determining market dominance.

According to the statute, “market dominance” means an absence of effective competition from other rail carriers or modes of transportation. In theory, a finding of “market dominance” gives the STB the authority to protect a captive shipper—one who has no alternative transportation

choices—from excessively high rates. By law, if a rail carrier proves that the rate charged is less than 180 percent of out-of-pocket costs, then that carrier is determined to be not market dominant. Market dominance was intended by Congress to be merely a threshold test for determining the agency's authority in hearing rate cases.

However, in implementing this part of the statute, regulators required a rail customer to prove that it did not have the ability to use another product ("product competition") or access a similar product from another geographic region ("geographic competition"). The addition of determining product and geographic competition as part of market dominance made what was originally intended to be only a threshold test into a lengthy, complicated and overly burdensome process.

On December 21, 1998, as a result of a rulemaking proceeding, the STB determined that factors of product and geographic competition should be removed from the market dominance determinations. This provision would simply codify this decision.

Captive rail shippers are very grateful that the STB heeded the complaints of railroad customers and removed the consideration of "product" and "geographic" competition from the "market dominance" test. This provision would simply codify the STB's December 21, 1998 decision.

### 13. Revenue Adequacy

Abolish the requirement that the Board determine on a regular basis which railroads are revenue adequate.

According to the STB, the revenue adequacy status of any particular railroad has little practical effect, and Congress may wish to consider legislatively abolishing the requirement that the Board determine on a regular basis which railroads are revenue adequate.

According to many financial analysts on Wall Street, the revenue adequacy status of any particular railroad is never even considered when determining the financial status of that railroad.

Finally, according to Dr. Alfred Kahn, the noted economist widely known as the "father of deregulation" for his work in deregulating the airline and trucking industries, the revenue adequacy test as currently applied by the Surface Transportation Board is nonsensical and should be abolished.

In short, the annual regulatory determination of revenue adequacy has little if any bearing on the realities of railroad economics unnecessarily polarizes the transportation community, and should be eliminated.

### **CONCLUSION**

We believe that any legislation to reauthorize the STB must include these provisions. These provisions do not “re-regulate” the rail industry; in fact, in most cases, they remove barriers to competition or adjust policies that are no longer appropriate in a consolidated industry. If these provisions are enacted, rail customers believe that we will see the growth of an inherently stronger rail industry that is responsive to customer needs and concerns. We look forward to working with you to accomplish just that.

**The following groups participate in the Rail Customer Coalition:**

Alliance for Rail Competition  
American Forest and Paper Association  
  
American Public Power Association  
  
Chemical Manufacturers Association  
  
Consumers for Rail Equity  
  
Edison Electric Institute  
  
The Fertilizer Institute  
  
National Association of Wheat Growers  
  
National Barley Growers Association  
  
National Council of Farm Cooperatives  
  
The Society of the Plastics Industry, Inc.  
  
Transportation Intermediaries Association  
  
United States Clay Producers Traffic Association